

# Recent housing market developments in Spain

Pana Alves and Alberto Urtasun

## **Abstract**

After the sharp correction during the crisis, activity in the Spanish real estate sector commenced its recovery in early 2014. This improving trend has since been observable both in quantity and price-based indicators. However, this market is well known for its high heterogeneity due to the location of the properties, their type and the nationality of purchasers. The recent buoyancy seems to reflect, among other factors, positive labour market developments and the low cost of borrowing against a backdrop of gradual growth of loans for house purchase.

**Keywords:** housing, prices, mortgage terms and conditions.

**JEL codes:** D12, E22, E24, G21.

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### Introduction

After the sharp correction during the crisis, activity in the real estate sector commenced its recovery in early 2014. The cumulative increase in real housing investment between 2013 Q4 and 2018 Q4 was 45%, compared with a rise of 15% in GDP in the same period. Other indicators also showed the cyclical improvement in this sector, such as transactions and prices. However, this sector is still highly diverse in terms of the location of properties, their type and the nationality of purchasers. The recent buoyancy seems to reflect, among other factors, positive labour market developments and the low cost of borrowing against a backdrop of gradual growth of loans for house purchase.

First, this article reviews recent developments in the main activity indicators (investment, transactions and new building starts) and house prices from an aggregate and disaggregate perspective (see Sections 2 and 3, respectively). Next, it analyses the financial conditions of the sector (Section 4). Lastly, recent developments in the rental market are described briefly (Section 5).

### Housing market developments: recent aggregate indicators

As is usual during economic recoveries, in Spain gross capital formation is on a buoyant path. This applies especially to non-construction investment which exceeded its pre-crisis level last year (see Banco de España (2018)). Within this improvement, construction investment was weaker. This shows, on one hand, the readjustment in housing investment which, supported by the latest recovery reached levels of close to 5.5% of GDP in 2018, in line with other European countries, compared with 12% before the crisis (see Chart 1). On the other, the weight of other construction investment as a percentage of GDP remained low in the last few years, following a ten-year decline.<sup>1</sup> It decreased from 9.4% of GDP in 2006 to 5.1% in 2018.

Housing transactions also show the upward trend experienced by the sector in the last five years. Specifically, it is estimated that there were slightly more than 550,000 house purchases in 2018, approximately 10% more than in 2017. However, this is much lower than the house purchases during the pre-crisis real estate boom. For example, average annual housing transactions stood at around 885,000 during the period 2004-2007 (see Chart 2.1).

In parallel, following a sharp adjustment during the crisis, house prices, have grown since they touched bottom in 2014 Q1 (see Chart 2.2). In cumulative terms, prices climbed by around 27% in nominal terms (22% in real terms) between the start of 2014 and the end of 2018 (see Chart 2.3).<sup>2</sup>

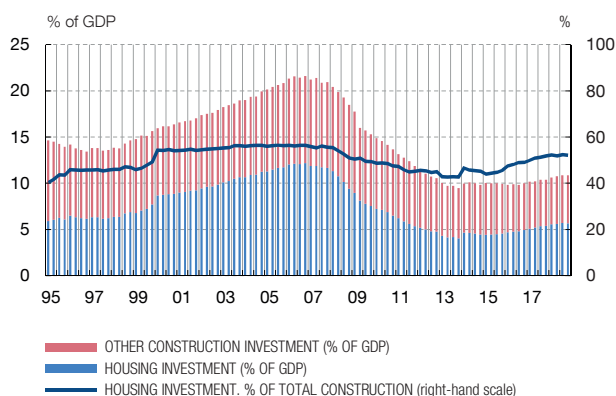
Residential housing starts also improved, albeit with a slight lag, possibly due to the high unsold housing stock, resulting from the robust increase in supply during the previous

<sup>1</sup> The performance of other construction investment largely reflects the impact of the fiscal consolidation process which was essentially based on public-sector construction investment, including investment in transport infrastructure.

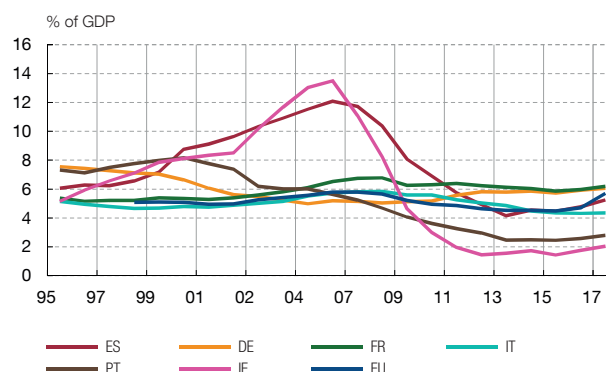
<sup>2</sup> From their peak in 2007 Q3 until their trough in 2014 Q1, house prices fell by 37% in nominal terms (45% in real terms).

Construction investment was weaker than other investment components. In 2017 it stood at around 50% of its pre-crisis level. The readjustment of housing investment, despite its more recent recovery, is shown by its weight as a percentage of GDP which has moved back onto a normal footing at levels of close to 5% of GDP in 2017, in line with other European countries.

1 BREAKDOWN OF CONSTRUCTION INVESTMENT



2 HOUSING INVESTMENT (% OF GDP). INTERNATIONAL COMPARISON



SOURCES: Spanish National Accounts and European Commission.



boom which was not absorbed during the crisis, given weak demand<sup>3</sup> at that time. In any event, housing starts remain at all-time lows (see Chart 2.4).

As for the match between new housing demand and supply, since 2013 demand levels (house purchases, measured by new housing transactions registered before notaries) have continuously exceeded new supply levels (completed houses, measured by building completion certificates). This means that the volume of unsold homes – estimated to be around 500,000 units mid-2018 – have slowly, but gradually, been absorbed (see Charts 2.5 and 2.6). This slow correction of the stock could also be reflecting a slight mismatch between the characteristics of housing in demand, which include location, and the characteristics of housing available for sale.

### Mixed housing market developments

A particular feature of the Spanish real estate market is its high degree of diversity in terms of region, type of housing (new builds or existing properties) and the nationality of purchasers.

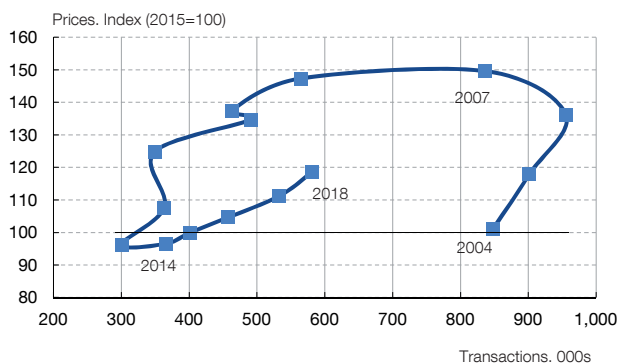
In recent years, house prices have performed dissimilarly in the different regions. Although prices generally moved upwards in all regions, the increase which had built up from their low during the crisis (that occurred in most regions in 2014) amply exceeded 20% in the most buoyant regions (49% in Madrid and 39% in Catalonia), whereas in the weaker regions it stood at around 8% (see Chart 3.1). The rate of increase in house purchases is also very mixed by region (see Chart 3.2).

As for supply, a comparison between housing approvals recorded in 2018 and their low during the crisis, shows that they recovered by more than 200% in Catalonia, Andalusia

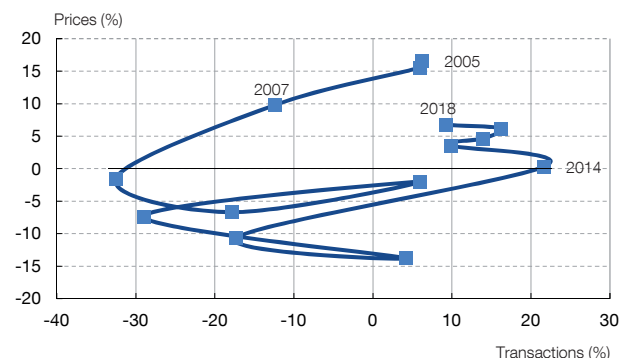
<sup>3</sup> The concept of unsold housing “stock” is the differential which has built up since 2004 between the volume of completed houses and the number of new house purchases. Thus, it is assumed that this stock was negligible in 2003. Therefore, this measure approximates the overhang of unsold houses during the crisis and how it has decreased. However, since the depreciation rate of these assets is very small, their initial condition is very significant. Consequently, the estimation of this series is subject to high uncertainty.

Housing transactions also show the upward trend experienced by the sector in the last five years. Specifically, there were slightly more than 550,000 house purchases in 2018, approximately 10% more than in 2017. However, this is much lower than the house purchases during the pre-crisis real estate boom.

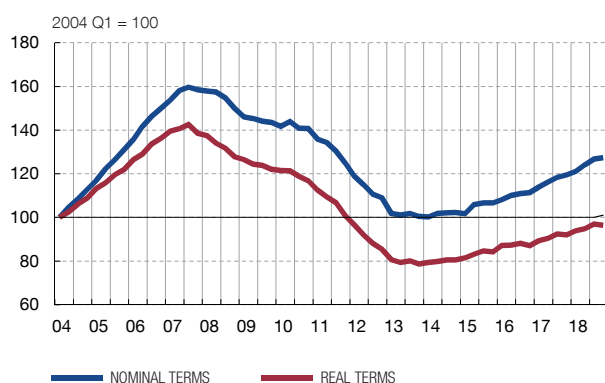
## 1 LEVELS



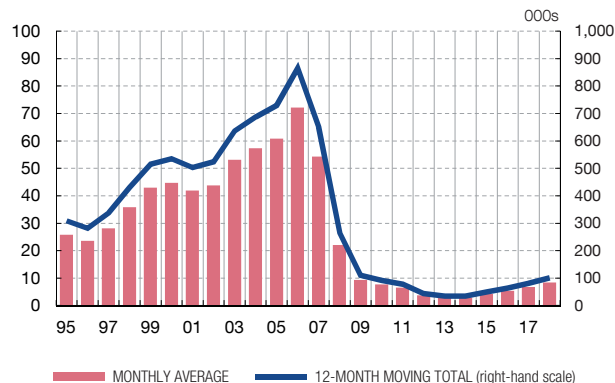
## 2 ANNUAL RATES OF CHANGE



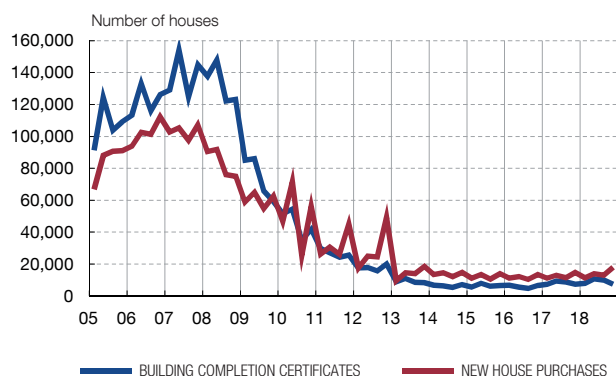
## 3 HOUSE PRICES



## 4 NUMBER OF HOUSING APPROVALS



## 5 NEW HOUSING DEMAND AND SUPPLY



## 6 UNSOLD HOUSING STOCK (a)



SOURCES: INE, Ministerio de Fomento and Banco de España (based on data from the Ministerio de Fomento).

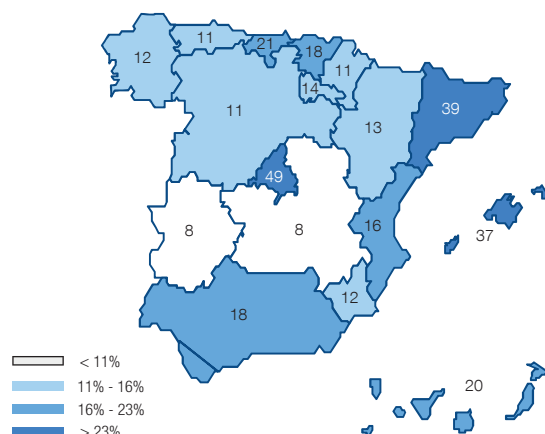
a The unsold housing stock is the differential which has built up since 2004 between completed houses and new house sales.

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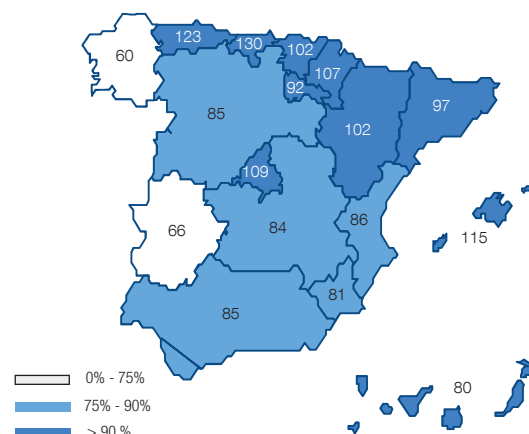
and the regions of Madrid and Valencia, whereas in other regions overall growth was lower than 90% (see Chart 3.3). There is no single pattern of the relationship between price and demand, supply and stock (see Chart 3.4) at region level, which indicates that the housing market is slightly segmented. In particular, these data seem to confirm that the characteristics of housing in demand do not necessarily coincide in some areas with the available supply and characteristics such as size, quality and location may differ.

The cross-regional performance of prices and transactions is mixed and is a highly significant factor for understanding the housing market in Spain.

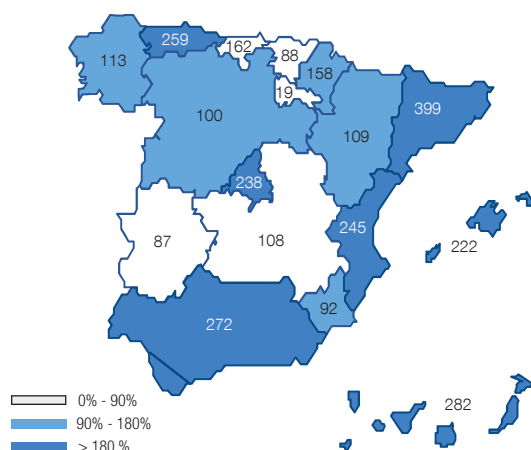
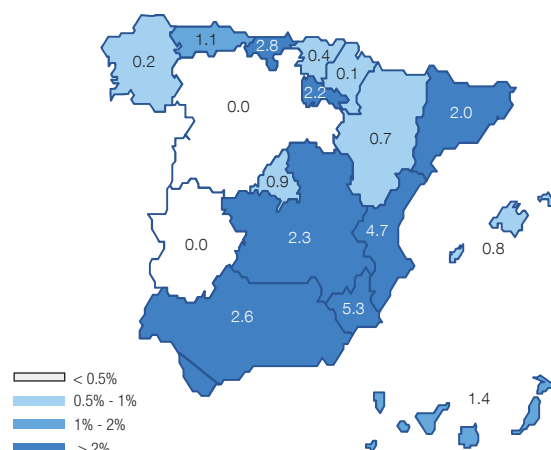
1 NOMINAL GROWTH OF HOUSE PRICES SINCE THE LOW. 2018 Q3



2 GROWTH OF HOUSING TRANSACTIONS SINCE THE LOW. 2018 Q3



3 GROWTH OF HOUSING APPROVALS SINCE THE LOW. 2018 Q3

4 ESTIMATE OF UNSOLD HOUSING STOCK. 2018 Q4  
Percentage of total housing in 2017 (a)

SOURCES: INE, Ministerio de Fomento and Banco de España (based on data from the Ministerio de Fomento).

a The unsold housing stock is the differential which has built up since 2004 between completed houses and new house sales.

The developments in another indicator which shows some disparity is purchases by housing type. During the current phase of recovery, purchases were mainly underpinned by the used housing segment whereas purchases of new homes moved on a slightly downward trajectory,<sup>4</sup> although they seem to have stabilised in 2018 (see Chart 4.1). Since the low reached in 2014, growth of new house prices has been slightly higher than that of second-hand homes, albeit with some exceptions. That said, the price per square metre of brand-new homes remains higher (see Charts 4.2 and 4.3).

As for the nationality of purchasers, the increase in housing sales is visible in purchases by foreigners (around 16% of the total in 2018<sup>5</sup> compared with an average of 10% during the period 2007-2013) and in acquisitions by Spanish residents (see Chart 5.1). The British

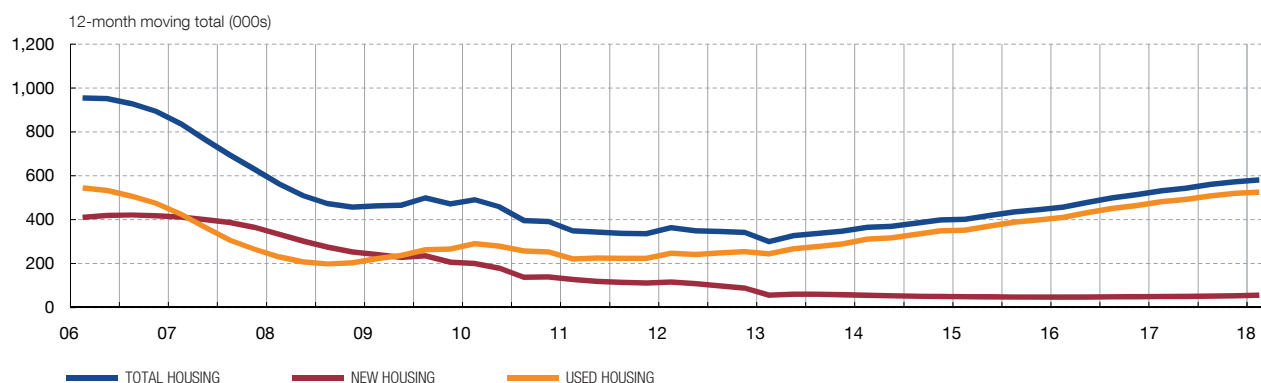
<sup>4</sup> As discussed in the previous section, housing starts remain at all-time lows.

<sup>5</sup> Data from the first half of 2018.

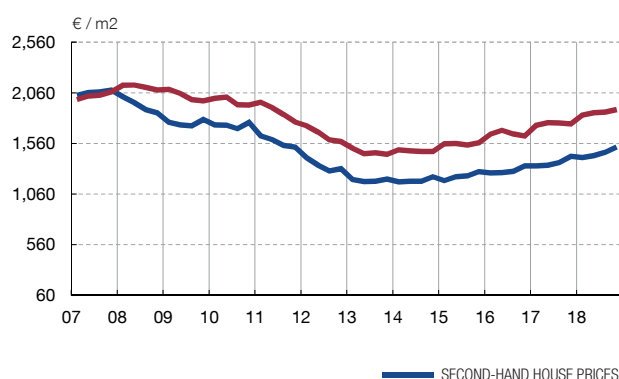


During the recovery, purchases were mainly underpinned by the used housing segment, whereas purchases of new homes held on a slightly downward trajectory.

## 1 NUMBER OF HOUSE PURCHASES



## 2 HOUSE PRICES IN EURO PER SQUARE METRE



## 3 YEAR-ON-YEAR GROWTH OF HOUSE PRICES



SOURCES: INE and Ministerio de Fomento.



have the highest weight in total house purchases by foreigners (14%), followed by the French and Germans (8% each) and the Romanians and Moroccans (7% each).<sup>6</sup> There has been a significant reduction in house purchases by Britons since 2017, which is possibly linked to Brexit, since the average during 2018-2016 was 19%. Based on their geographical distribution, house purchases by foreigners have a significantly greater weight in the Mediterranean regions and in the islands (see Chart 5.2).

## The financial setting

One of the factors underpinning the pick-up of the housing market has been the improvement in financing conditions.<sup>7</sup> Thus, the synthetic interest rate<sup>8</sup> applied to new mortgage loans fell from 3.1% at the beginning of 2014 to around 2.1% in February 2019 (see Chart 6.1). The breakdown of transactions based on the interest-rate reset period shows that costs declined more steeply for loans whose terms and conditions are reviewed after five or more years (a segment including fixed-rate and mixed-rate loans). This segment's costs decreased by around 3.3 pp over that period, compared with the costs of

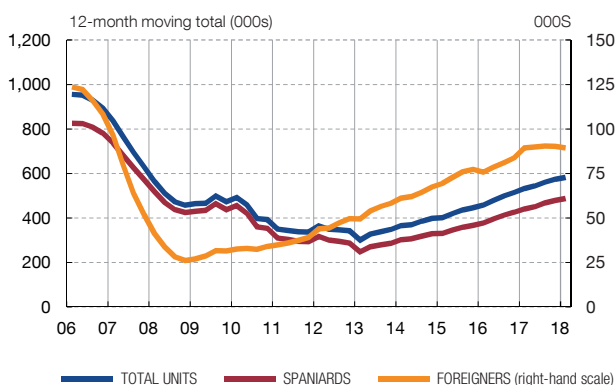
<sup>6</sup> Most of the Moroccans and Romanians who purchase houses are residents in Spain.

<sup>7</sup> However, as a result of changes in lending policies since the crisis, these improvements in financing conditions have not been distributed uniformly across households.

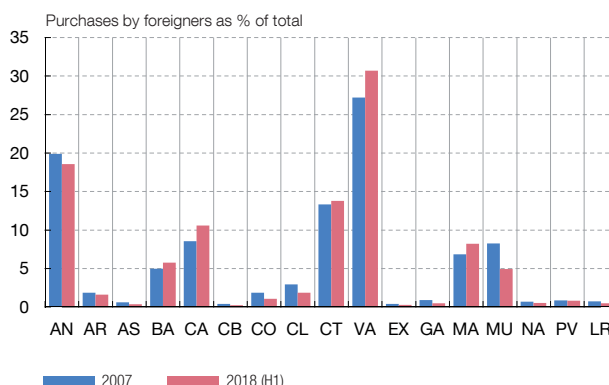
<sup>8</sup> The interest rate mentioned here is the narrowly defined effective rate (NDER), which excludes associated costs such as mortgage payment protection insurance premiums and fees and commissions which offset related direct costs. The NDER is defined in *Banco de España Circular 1/2010 of 27 January 2010*.

As for the nationality of purchasers, the increase in housing sales is visible in purchases by foreigners and in acquisitions by Spaniards.

1 NUMBER OF HOUSE PURCHASE TRANSACTIONS BY SPANIARDS AND FOREIGNERS



2 HOUSE PURCHASES BY FOREIGNERS PER REGION



SOURCE: Ministerio de Fomento.



mortgages with a reset period of up to one year (essentially floating-rate mortgages), which fell by 1.3 pp. This decline is not on account solely of lower key policy rates (generally the twelve-month EURIBOR for floating-rate mortgages and the swap interest rate at the corresponding term for other mortgages); the reduction in lending margins applied is also a determining factor. These factors account for approximately half of the fall in mortgages whose interest rate is revised each year and approximately 100 bp in mortgages which are revised after more than five years.

In parallel, the average repayment period for new mortgage loans has lengthened in recent years, more significantly in the case of fixed interest rate loans,<sup>9</sup> which stood at more than 22 years at end-2018, up from less than 13 in early 2014 (see Chart 6.2). The extension of fixed-rate mortgage repayment periods, in a setting of low interest rates, has made this product more attractive for borrowers, leading to a strong increase in the proportion of new mortgages taken out at fixed rates (from just 6% in 2014 to 40% in February 2019)<sup>10</sup> (see Chart 6.3).

The Bank Lending Survey (BLS) also shows that overall lending conditions in the house purchase loan market have improved in recent years, mainly reflected in a decline in the margins on ordinary loans and, to a lesser extent, in non-interest rate charges<sup>11</sup> (see Chart 6.4).<sup>12</sup> By contrast, according to the banks surveyed, margins on riskier loans increased somewhat, as did collateral requirements. Furthermore, as shown by data from the Association of Registrars, the median value of the mortgage loan to house transaction price ratio has remained stable at 80% since 2012, after having fallen sharply during the crisis.<sup>13</sup>

9 Fixed-rate mortgage loans are those whose interest rates stay the same throughout the life of the loan. Mortgages with a fixed interest rate for part of the life of the loan and a variable interest rate for another part, also called mixed mortgages, are considered variable-rate mortgages; therefore, they are not included in this category.

10 For a more detailed analysis, see “Box 6. Recent changes in interest-rate reset terms for new housing loans”, *Economic Bulletin*, 1/2017, Banco de España.

11 These are various kinds of fees which may be part of the pricing of a loan, such as commitment fees on revolving loans, administration fees (e.g. document preparation costs) and charges for enquiries, guarantees and credit insurance.

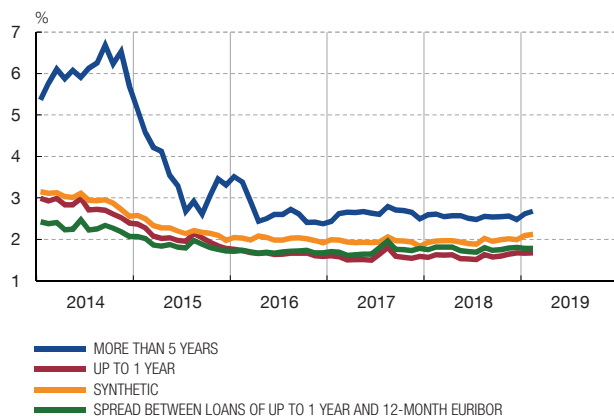
12 For further details, see the quarterly analytical articles published in the Banco de España *Economic Bulletin* on the results of the Bank Lending Survey.

13 For further discussion of the loan-to-value and loan-to-transfer value ratios, see the analytical article “The loan to value ratio for housing in Spain over the period 2004-2016”, *Economic Bulletin*, 1/2019, Banco de España.

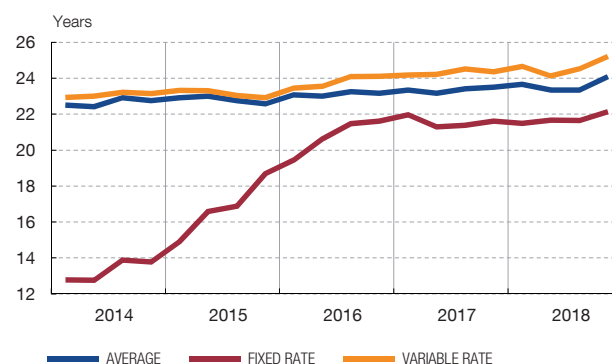


During recent years, there has been an improvement in the financing conditions applied to loans for house purchase. Interest rates have decreased and repayment periods have lengthened, particularly in fixed-rate mortgages, which has increased their appeal and triggered a rise in their relative weight. Furthermore, credit standards and general financing conditions have eased. The improvement in financing conditions has contributed to the recovery of lending, although outstanding bank lending has continued to contract since the new lending volume has remained below the amount of repayments.

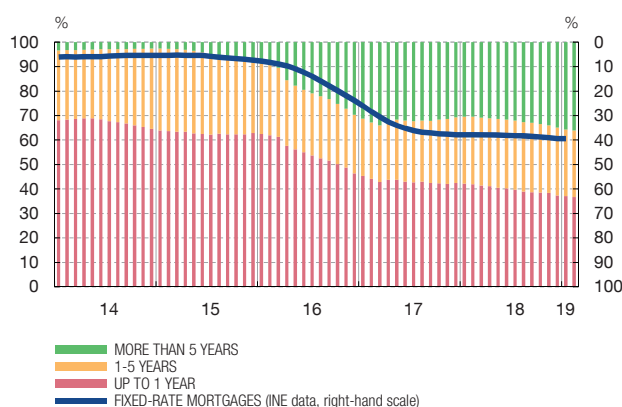
1 INTEREST RATES OF MORTGAGES ACCORDING TO RESET PERIOD OF TERMS AND CONDITIONS



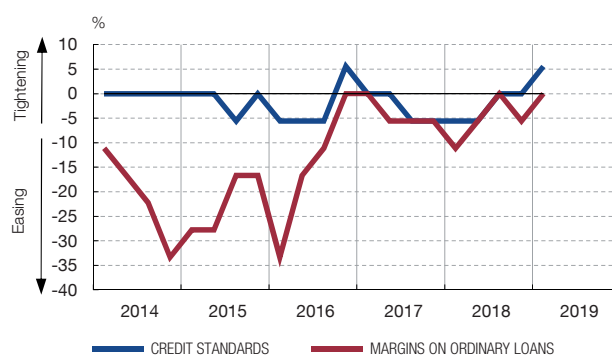
2 AVERAGE LOAN REPAYMENT PERIOD



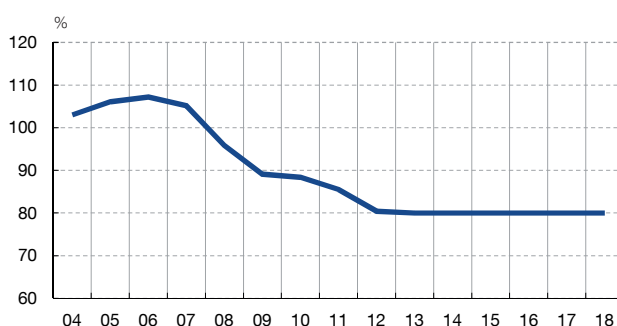
3 WEIGHT OF NEW LOANS ACCORDING TO INTEREST-RATE RESET PERIOD Cumulative 12-month flow



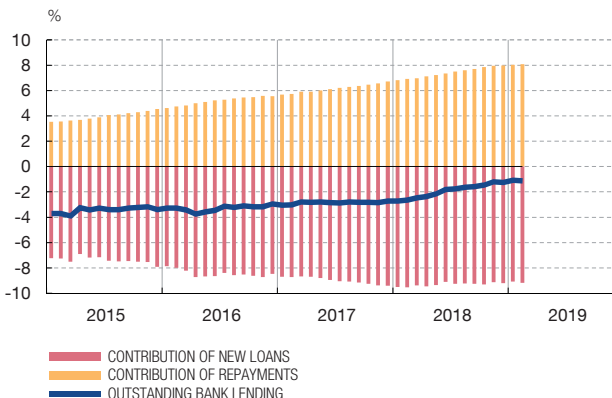
4 BLS: CHANGE IN CREDIT STANDARDS AND MARGINS APPLIED TO LOANS (a)



5 LOAN TO TRANSACTION PRICE RATIO OF NEW LOANS (b)



6 YEAR-ON-YEAR GROWTH OF BANK LENDING



SOURCES: Banco de España, Colegio de Registradores and INE.

- a Indicator = percentage of banks which have tightened their credit standards or margins considerably  $\times$  1 + percentage of banks which have tightened their credit standards or margins somewhat  $\times$  1/2 – percentage of banks which have eased their credit standards or margins somewhat  $\times$  1/2 – percentage of banks which have eased their credit standards or margins considerably  $\times$  1.
- b Median value of the ratio.

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The BLS also shows that credit standards for these loans have eased in recent years. According to the banks surveyed, the factors contributing to this are, by order of importance: the better outlook for economic activity in general, borrowers' greater solvency, increased competition among lenders and more favourable prospects for the housing market. In line with the changes in credit standards and with the greater solvency of applicants, the percentage of rejected loan applications in this segment has tended to decline since 2015, according to the responses of the banks participating in the BLS.

The increase in supply in the segment of loans for house purchase in recent years has been accompanied by an increase in demand, resulting in ongoing growth in the new lending volume. In spite of this, the moderation of the year-on-year rate of decline in the outstanding debt balance has been slow, having dropped from 3.7% at end-2014 to 1.1% in February 2019. This is because the greater buoyancy of new loans has largely offset the acceleration of repayments, which in turn is the result of the high stock of debt accumulated during the pre-crisis boom (see Chart 6.6). However, since the beginning of 2018, repayments have ceased to grow, stabilising at around €12 million per quarter. This has led to a quicker decline in the rate of contraction of the outstanding bank debt balance.

### The rebound in rental housing

From an international viewpoint, the proportion of the population that rents a home in Spain is still low (see Chart 7.1). However, the most recent data from the Living Conditions Survey (LCS) point to an increase in the last few years in the percentage of households that rent (16.9% in 2017, up from 14.2% in 2008). Although home ownership continues to be prevalent, home rental is gaining weight (see Chart 7.2).<sup>14</sup> Although this trend towards a greater weight of rental housing is widespread, it has grown the most among 16-to-29 year-olds, followed by 30-44 year-olds (see Table 1). This change may be explained, at least in part, by factors linked to the impact of the economic crisis on these population segments, but possibly also by sociological factors linked to changes in preferences. Also, the tax bias favouring house purchase over rental has decreased in this period due to the tax changes introduced.

Driving economic factors include most notably the impact of the recession on labour market conditions, particularly for young individuals. On data from the Structure of Earnings Survey, between 2008 and 2016 average earnings fell 15% for employees between 20 and 24 years old and 9% for those between 25 and 29. But young people also saw how other labour conditions deteriorated. Specifically, the unemployment rate for employees aged between 16 and 29 peaked at 42.4% (2013), with an incidence of long-term unemployment of 52.1% (2014) and a ratio of temporary to total employees of 57.4% (2017). However, these indicators were slightly less negative in 2018 (29.3%, 35.8% and 56.3%, respectively).

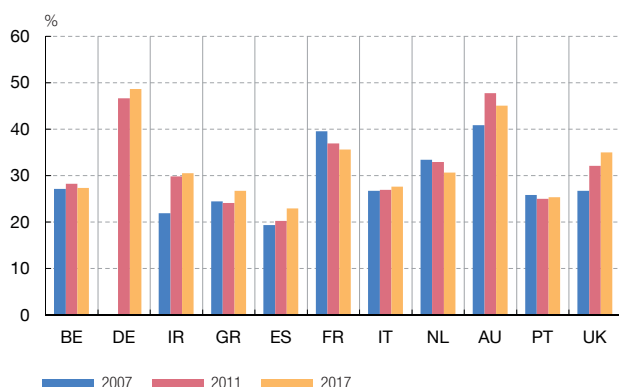
Housing taxation has undergone reforms in recent years. The tax credit for purchase of principle residence was last eliminated on 1 January 2013. Also, taxes on home ownership and house purchases (specifically transfer tax in some regions and VAT in all regions) have been raised, so that their weight in GDP has increased in Spain over the last few years.<sup>15</sup> These seem to be the most significant changes as regards reducing the tax bias in favour of house purchase vis-à-vis rental, since tax benefits for house rental continue to be low by international standards.

<sup>14</sup> Census data also seem to point towards a minor increase in the weight of rental housing. The 2011 census shows an increase in the weight of the rental market for the first time (13.5%, compared with 11.4% according to the 2001 census).

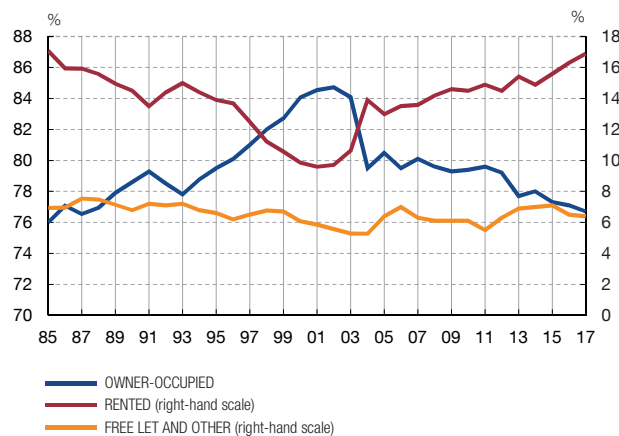
<sup>15</sup> See López-Rodríguez and García Ciria (2018).

The proportion of the population that rents a home in Spain is small. However, the latest data available point to an increase in the percentage of households that rent in recent years. Although the trend towards a greater weight of rental housing is widespread, it has grown the most among 16-to-29 year-olds, followed by 30-to-44 year-olds.

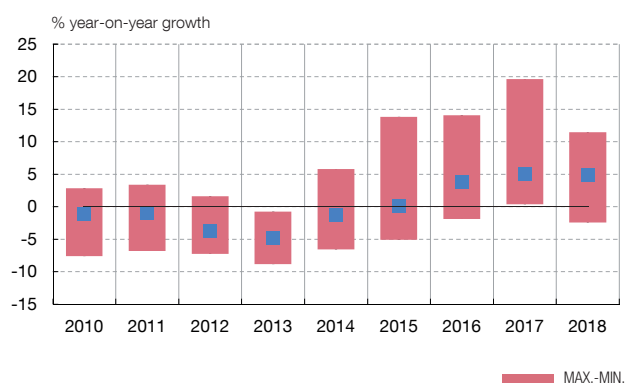
1 PROPORTION OF POPULATION THAT RENTS A HOME



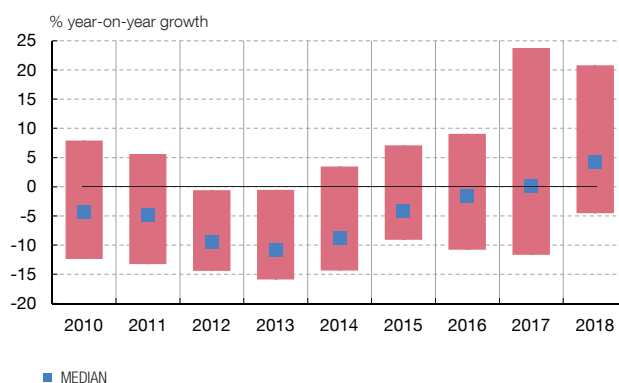
2 TENURE STATUS (% OF MAIN RESIDENCES) (a)



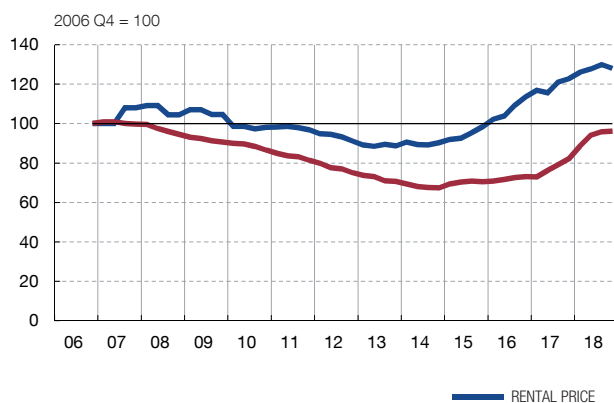
3 HOUSING RENTAL PRICES (b)



4 HOUSE PURCHASE PRICES (b)



5 RENTAL VS. SALE PRICES IN MADRID (c)



6 RENTAL VS. SALE PRICES IN BARCELONA (c)



SOURCES: INE, Eurostat, Idealista and Banco de España.

a Until 2004, Household Expenditure Survey; since 2005, Living Conditions Survey (LCS).

b Year-on-year growth of price per m2 in December.

c Half-yearly data until 2010. The observations of June and December were allocated to March and September, respectively.



Percentage of homes per tenure status and age of the reference person.

	At market price		Below market price	
	2008	2017	2008	2017
Total	11.0	14.3	3.1	2.6
16-29 years old	32.3	48.9	5.2	3.3
30-44 years old	16.2	25.1	2.5	2.9
45-64 years old	8.0	11.3	3.1	2.7
65 and above	3.7	4.3	3.4	2.2

SOURCE: LCS (INE).

Rental income has also increased significantly in the most recent period. For example, according to information from the real estate portal Idealista,<sup>16</sup> rental income grew 9.3% in 2018 (showing some moderation compared with the 18.4% increase posted a year earlier). As occurs with purchase prices, rental price growth rates are also highly heterogeneous by region (see Charts 7.3 and 7.4). However, the difference between the highest and the lowest growth is smaller in the case of rentals, having ranged from -2% (Barcelona) to 11% (San Sebastián) in 2018.

In Madrid and Barcelona rental prices were much more stable than sale prices during the recession, and yet they started to recover earlier afterwards (see Charts 7.5 and 7.6). Although with a slight lag, sale prices have also increased significantly in these cities, standing close to the level of 2006. In any event, while sale prices have not reached the pre-crisis level, rental prices have exceeded it.<sup>17</sup> Notably, in 2018 rental prices posted weak growth in comparison with previous years, even dropping in the case of Barcelona. Sale prices in Barcelona also slowed (according to this source of information, from more than 15% in 2017 to less than 3% in 2018).

11.4.2019.

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<sup>16</sup> These indicators should be regarded with due caution. For a more detailed analysis, see López-Rodríguez and Matea (2019) forthcoming.

<sup>17</sup> The lack of data relating to the pre-crisis period makes it difficult to analyse in depth the relative performance of the two prices.